ORIGINAL

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BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF PAYSON WATER CO., INC., AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE FAIR VALUE OF ITS UTILITY PLANTS AND PROPERTY AND FOR INCREASES IN ITS WATER RATES AND CHARGES FOR UTILITY SERVICE BASED THEREON.	DOCKET NO: W-03514A-13-0111
IN THE MATTER OF THE APPLICATION OF PAYSON WATER CO., INC., AN ARIZONA CORPORATION, FOR AUTHORITY TO: (1) ISSUE EVIDENCE OF INDEBTEDNESS IN AN AMOUNT NOT TO EXCEED $1,238,000 IN CONNECTION WITH INFRASTRUCTURE IMPROVEMENTS TO THE UTILITY SYSTEM; AND (2) ENCUMBER REAL PROPERTY AND PLANT AS SECURITY FOR SUCH INDEBTEDNESS.	DOCKET NO: W-03514A-13-0142 **NOTICE OF FILING RESPONSIVE TESTIMONY**

Payson Water Co., Inc. hereby submits testimony of Jason Williamson and Thomas J. Bourassa in response to the Staff Report filed in this matter on September 18, 2013. See **Attachment 1**.

RESPECTFULLY SUBMITTED this 23rd day of September, 2013.

FENNEMORE CRAIG, P.C.

By
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ORIGINAL and thirteen (13) copies
of the foregoing were filed
this 23rd day of September, 2013, with:

Docket Control
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, AZ 85007

COPY of the foregoing was hand delivered
this 23rd day of September, 2013, to:

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8523008.1/073283.0006

Attachment 1

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Jay L. Shapiro (No. 014650)
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Attorneys for Payson Water Co., Inc.

BEFORE THE ARIZONA CORPORATION COMMISSION

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RESPONSIVE TESTIMONY OF
JASON WILLIAMSON

September 23, 2013

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8525209.1/073283.0006

I. INTRODUCTION, PURPOSE AND SUMMARY

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Jason Williamson. My business address is 7581 E. Academy Boulevard, Suite 229, Denver, Colorado 80230.

Q. ON WHOSE BEHALF ARE YOU TESTIFYING?

A. On behalf of the Applicant, Payson Water Co., Inc. ("PWC" or the "Company").

Q. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY IN THIS PROCEEDING?

A. Yes, my prefiled direct testimony was submitted in August in support of the Company's request to consolidate and expedite the financing and rate applications.

Q. WHAT IS THE PURPOSE OF THIS TESTIMONY?

A. To respond to the Staff Report for Phase I filed on September 18, 2013.

Q. WOULD YOU PLEASE SUMMARIZE THE COMPANY'S RESPONSE TO THE STAFF REPORT?

A. The Company agrees with Staff on what appears to be the most important point: "the opportunity to alleviate the burden to the ratepayer before next summer with the building of the interconnection with the Town of Payson is an exigent circumstance that warrants the extraordinary relief requested by the Company and supported by Staff."[1] However, Staff's support comes with conditions. Some of those conditions would cause harm to the Company.

First, is the recommendation that the Company's Emergency Interim Water Augmentation Surcharge Tariff ("Water Augmentation Tariff") be "immediately" eliminated. Second, is the recommendation that the Company record the WIFA loan surcharge proceeds as Contributions in Aid of Construction ("CIAC").[2]

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[1] Staff Report at 3.

[2] This problem of CIAC treatment of the surcharge proceeds is explained in more detail in the Responsive Testimony of Thomas J. Bourassa. Mr. Bourassa also addresses the Company's concerns over the methodology used in

Neither of these conditions is necessary for the Company to accomplish the goal here – construction of the interconnection between our Mesa del Caballo (MDC) system and the Town of Payson's water supplies (the "Interconnection"). As a result, I will offer an alternative approach regarding the augmentation tariff that would limit the significant downside risk to the Company.

Q. DOES THE COMPANY HAVE ANY OTHER CONCERNS WITH THE STAFF REPORT?

A. Yes. First, in the purchased water surcharge Staff used in its examples is \$2.75 per 1000 gallons as the commodity cost of the water to be purchased from the Town.[3] I suspect Staff got that number from the Company's rate application, <u>but that number relates to water from the Cragin pipeline</u>, which is not completed or in service. The water we purchase <u>now</u> from the Town and the water we will deliver through the Interconnection is currently priced by the Town at approximately \$7.48 per 1000 gallons. This is not a special rate – it is the rate that the Town of Payson also charges the Tonto Apache Tribe, and two of the Payson schools. When the Cragin pipeline begins operation (estimated to be in 2016) the cost is anticipated to go down to \$2.75); but the \$7.48 is the current Town rate over which we have no control.

Second, in its report Staff states that the Commission should affirm it will decide the rate case by the "end of 2014." While this language is not repeated in the actual condition (Staff Condition No. 11), I am concerned it will cause confusion. To be absolutely clear, the only reason we concluded that we could proceed to build the Interconnection without an interim increase in our overall revenue requirement, was Staff's stipulation and Judge Nodes' approval of a

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Staff's proposed purchased water adjuster.

[3] Staff Report at Attachment C.

procedural schedule that will have the new rates in place by May 1, 2014. I really cannot overstate the dire financial condition this Company is in at this time and the absolute necessity of completing the general rate case in accordance with the timeframe in the existing procedural order (i.e., final Commission decision and rates in place by May 1, 2014.)

II. RESPONSE TO STAFF'S REPORT AND RECOMMENDED CONDITIONS

A. Immediate Elimination of the Water Augmentation Tariff

Q. WHAT EXACTLY DOES STAFF RECOMMEND?

A. Staff's Condition No. 3 calls for the "immediate elimination" of the Water Augmentation Tariff.[4]

Q. WHAT DID THE COMPANY RECOMMEND WITH RESPECT TO THE WATER AUGMENTATION TARIFF?

A. Nothing in this stage of the proceeding. We are seeking approvals needed so we can build a transmission line that we expect will, at a minimum, dramatically limit and hopefully eliminate the need to regularly haul water to MDC.

Q. SO YOU AGREE THAT ELIMINATING THE WATER AUGMENTATION TARIFF IS A GOAL?

A. No, I do not think "eliminating the water augmentation tariff" is the goal of this proceeding. Eliminating the need to haul water on a regular basis in the summer is the goal. Eliminating hauling means much lower bills for our customers and the likely easing of the curtailment restrictions. But, to begin with, the line is not yet built. If we get the necessary approvals, we will borrow the money, hire the contractor and move as fast as we can. We hope to have the line done by Spring 2014 and in use before the water shortages typically start (i.e., late spring/ early summer). But what if we can't, through no fault of our own? What if the

[4] Staff Report at 4.

loan is delayed? What if the contractor does not complete the job? What if the section currently being constructed by the Town of Payson has delays? What if ADEQ prohibits us from using the line once it is operational? If the water augmentation tariff is immediately and irrevocably rescinded right now, before our work begins on the line, the Company faces extraordinary downside risk.

If, for any reason, we cannot get the line in operation by May 2014, we would face an impossible situation next summer without any means to recover the cost of hauling water to MDC. If the contractor's equipment fails, we would haul water at huge cost with no means of recovery. If the winter in Payson doesn't cooperate and comes later or harder than usual, we would haul water at huge costs with no means of recovery. If the contractor has issues, either with the job, the permitting, or within their own company, we would haul water at huge costs with no means of recovery. I can think of a lot of situations, all outside our control, that could happen and if any one of them does happen, PWC faces massive financial risk.

Q. BUT IF YOU RETAIN THE HAULING TARIFF, WHAT INCENTIVE WOULD YOU HAVE TO BUILD THE INTERCONNECTION <u>AS SOON AS POSSIBLE</u>?

A. Eliminating the need to haul water all summer is a powerful incentive. The Company is already committed to the Cragin pipeline project for this reason. And since buying this Company, I have spent hundreds of hours addressing MDC. We get the same calls and complaints as the Commission does. That's why I have spent all this time, and why we are spending tens of thousands of extra dollars in expedited Commission proceedings. Because building the Interconnection as soon as possible is the best thing for the Company and its customers.

It should be recalled that just a few months ago, the best plan we had was to wait until Cragin Water was available in 2016, and endure three more summers of augmentation. I certainly would not have proposed the Interconnection plan if my intent was to do anything other than to solve this issue prior to Summer 2014. And if for some reason the line isn't in place, I fully expect our customers, the Commission Staff, and the Commissioners to be "all over me" asking for explanations and resolution. I have already committed a lot of time and money to get this line built and we are the ones that have the most to lose now if this line doesn't get built in time to avoid hauling. But without the hauling tariff, I would also have the real threat of the Company simply not surviving.

Q. COULD THE AUGMENTATION TARIFF BE ELIMINATED WHEN YOU FINISH THE INTERCONNECTION?

A. That's one option and it's better than the current option in the Staff Report.

Q. IS THERE ANOTHER OPTION?

A. Yes. Actually, we believe there is a way to immediately eliminate the Water Augmentation Tariff but still protect the Company from unintended consequences.

Q. HOW DO YOU PROPOSE TO DO THAT, MR. WILLIAMSON?

A. By modifying Staff's proposed Purchased Water Adjuster (PWA) tariff. A copy of the Company's modified proposed PWA is attached to this testimony as **Exhibit JW-RT1**.

Q. HOW HAVE YOU MODIFIED STAFF'S PROPOSED TARIFF?

A. Staff's tariff was limited to water purchased from Payson and delivered through the Interconnection. But this fails to recognize that there are circumstances where use of the Interconnection may be prohibited for reasons outside the Company's control. The Company's version of the PWA addresses this by (1) making the Interconnection the sole delivery source absent emergency circumstances; then (2) defining the limited circumstances in which an emergency would exist; and (3) adding to Staff's already stringent notice requirements in the event an emergency requires delivery by some means other than the Interconnection.

Again, I appreciate that Staff wants to eliminate the Water Augmentation Tariff now – because that will give solace to customers. But to do so before we even make the application to borrow the money to build the Interconnection is a recommendation that puts the Company at great risk. I don't think we should be penalized for finding a way to get more water to MDC sooner by taking away our safety net. We already have every incentive to complete the Interconnection as soon as possible. And we have a way to eliminate the tariff now and protect the Company. It seems to me like this should satisfy everyone.

B. <u>Timing of Permanent Rates</u>

Q. IN YOUR SUMMARY YOU MENTIONED A CONCERN OVER THE TIMING OF THE RATE CASE. DO YOU WISH TO ADDRESS THAT CONCERN FURTHER?

A. Yes, briefly. As I testified above, one place in the Staff Report recommends that the Commission decide the underlying rate case "before the end of 2014."[5] Then in Staff's Condition No. 11 it simply says process the rate case with a final decision resulting in a debt service coverage of 1.2 or greater.[6] This is confusing to me.

Q. WHEN DOES THE COMPANY EXPECT NEW RATES TO BE SET?

A. The time clock on the rate case expires around the beginning of March 2014. We agreed to extend the time clock to start the hearings in January 2014 instead of December 2013, when we submitted a proposed procedural schedule with Staff. That schedule contemplated the Commission issuing a final order setting new rates

[5] Staff Report at 3.
[6] Staff Report at 5.

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PHOENIX

in April 2014 with those rates going into effect in May 2014.

Q. WHAT WILL HAPPEN IF NEW RATES ARE DELAYED BEYOND THAT DATE?

A. We have agreed not to seek an interim increase in our revenue requirement and to go ahead and build the Interconnection, but there is little chance we can keep operating beyond May 1, 2014 without more revenue. WIFA staff is already making an exception to their loan covenants by stating they will recommend a loan to us when we cannot meet the 1.2 debt service coverage requirement, with the caveat that they expect new rates to be in place by mid-year. That's what the most recent procedural order in this case contemplates. We bear the responsibility and the risk for buying a utility in dire financial condition, but the Company has addressed the condition through its application for permanent rates, which rates are necessary to get its financial ship in order as soon as possible.

C. <u>Purchased Water Cost</u>

Q. EARLIER YOU EXPLAINED THE PROPOSED MODIFICATIONS MR. WILLIAMSON, BUT CAN YOU TAKE A STEP BACK AND EXPLAIN WHY THE COMPANY NEEDS THE PWA?

A. Because there is no provision in our rates for recovery of water purchased from Payson for MDC and the Water Augmentation Tariff only covers hauled water.

Q. WHAT IS THE COST OF THE WATER PURCHASED FROM PAYSON?

A. Approximately $7.48 per 1000 gallons.

Q. DOES STAFF'S PROPOSED PWA USE A DIFFERENT NUMBER?

A. Yes, in the examples for calculating the surcharge Staff used $2.75 as the estimated cost of the water. While these are just examples, we have already received calls from customers wondering about the $2.75 price tag. It appears that Staff got the $2.75 from our filings – and I apologize for any misunderstanding, but the $2.75 is the cost we expect after the Cragin pipeline becomes operational, that's the Cragin cost. But the current cost of the water we buy from Payson is set by the Town, readily verifiable, and outside of our control. In fact, as I testified already, it is the same water we are buying now and hauling; with the interim pipeline we are just eliminating the hauling cost.[7]

Q. ARE ANY MODIFICATIONS REQUIRED TO ADDRESS THIS CONCERN?

A. Not to the tariff itself as this appears to have just been an illustration of the calculation. To help clear up any further confusion though, Mr. Bourassa has included illustrations of the calculation using the actual cost of $7.48 in his responsive testimony. He has also addressed the concern with the calculation methodology in his responsive testimony.

Q. DOES THIS COMPLETE YOUR RESPONSIVE TESTIMONY?

A. Yes.

[7] Testimony of Jason Williamson (filed August 15, 2013) at 6:15-17.

EXHIBIT JW-RT1

PURCHASED WATER ADJUSTOR

I. Purpose and Applicability

The purpose of this tariff is to equitably apportion the costs of water purchased ~~through an interconnection with~~ from the Town of Payson among Mesa Del Caballo customers. These charges are applicable to all connections and will be assessed based on usage, as more particularly provided below.

II. Definitions

Unless the context otherwise requires, the definitions set forth in R-14-2-401 of the Arizona Corporation Commission's ("Commission") rules and regulations governing water utilities shall apply in interpreting this tariff schedule.

"Company" means Payson Water Company, Inc.

"Interconnection"- means the interconnection between the Town of Payson's water system and the Company's Mesa del Caballo water system.

"Purchased Water Cost" means the actual cost billed by the Town of Payson for water purchased ~~through the interconnection between the Town of Payson's water system and~~ by the Company~~'s water system~~.

"Purchased Water Quantity" means the actual quantity (in thousands of gallons) of water billed by the Town of Payson for water purchased ~~through the interconnection between the Town of Payson's water system and the Company's water system~~.

"Purchased Water Surcharge" means the surcharge calculated in accordance with Section IV below.

"Surcharge Rate" means the rate per 1,000 gallons that is calculated in accordance with Section III below.

"Water Sold" means the actual quantity (in thousands of gallons) of water sold by the Company to its Customers during the month corresponding to the month in which water was purchased from the Town of Payson ~~through the interconnection between the Town of Payson's water system and the Company's water system~~.

III. Use of Interconnection

Unless an emergency exists that precludes the Company from using the Interconnection, the Interconnection shall be the sole means of delivering water purchased from the Town of Payson by the Company for its Mesa del Caballo system from the date the Interconnection is placed in service or May 15, 2013, whichever occurs first. An emergency will exist in the event that (1) the Company has been precluded from putting the Interconnection in service despite reasonable efforts; (2) the Interconnection is in service but not available due to non-routine repairs or maintenance that cannot be completed in 48 hours despite all reasonable efforts; or (3) the Company is otherwise prohibited from using the Interconnection by order of a court or agency with applicable jurisdiction.

IV. Surcharge Rate Calculation

For each month that the Company purchases water from the Town of Payson ~~through the interconnection between the Town of Payson's water system and the Company's water system~~, the Company will calculate the Surcharge Rate per the following example when all water is purchased from the Town of Payson.

Example (For Illustrative Purposes Only) - All water is purchased from the Town of Payson

A customer uses 4,500 gallons of water.

~~The commodity cost being billed by Payson Water Company to this customer would be $8.71 calculated as follows:~~

~~Per 1,000 Gallons~~				
~~0 to 4,000~~	~~$1.93~~	~~4.0 x $1.93~~	=	~~$7.72~~
~~Over 4,000~~	~~$2.99~~	~~0.5 x $2.99~~	=	~~$0.99~~
				~~$8.71~~

The commodity cost billed from the Town of Payson would be:

Per 1,000 Gallons	Cost per 1,000 gallons	Computation		Total
All Gallons	$7.48	4.5 x $7.48	=	$33.66

The surcharge for this customer would be:

Purchased Water Cost		Surcharge
$33.66	=	$33.66

Attachment A ~~C~~ of this Tariff ~~Staff Report~~ provides examples of the surcharge calculation when less than 100 percent of all water is purchased from the Town of Payson.

IV. Terms and Conditions

(A) Assessment and Billing of Purchased Water Surcharge: For any month in which water is purchased from the Town of Payson, after completing its billing for the month and receiving the Town's billing for the month, Payson will make the surcharge calculation to determine the Surcharge Rate.

In the following month, Payson will bill the Purchased Water Surcharge to its customers. Each individual customer's billing for the Purchased Water Surcharge will be based on that customer's actual usage for the previous month (the month corresponding to the water purchase from the Town) times the Surcharge Rate.

The Purchased Water Surcharge shall be presented as a separate line item on the customer billing.

(B) Notice to Commission: For any month in which the Company intends to bill customers a Purchased Water Surcharge, the Company shall provide Commission Staff notice of the Company's intent to bill the Purchased Water Surcharge. The notice to Commission Staff shall include the following:

1. The Purchased Water Cost.
2. The Purchased Water Quantity.
3. A copy of the bill received for the purchase of water from the Town of Payson.
4. A schedule showing the calculation of the Surcharge Rate in excel format with formulas intact, including a schedule showing the determination of the Avoided Production Costs.

In the event the Company is precluded from using the Interconnection for more than 48 hours for any reason, it shall notify the Commission promptly and prior to undertaking any other means to transmit water purchased from the Town of Payson. Such notice shall state the reasons the Interconnection is not available and include a description of the means by which the Company intends to transmit Purchased Water from Payson to its Mesa del Caballo system and an estimation of the additional costs, if such costs are to be included in the cost of Purchased Water cost under this tariff.

~~Attachment C~~

~~PURCHASED WATER SURCHARGE~~
~~EXAMPLE CALCULATIONS –~~
~~WHEN LESS THAN 100 PERCENT~~
~~OF ALL WATER PURCHASED~~
~~FROM THE TOWN OF PAYSON~~

COMPANY REVISED STAFF COMPUTATION Attachment A

Surcharge Calculation Example - When Less Than 100% of All Water Purchased From Town of Payson

Examples assume that 25% of total water purchased from the Town of Payson

Example 1 - Median Usage Customer

This example illustrates how the surcharge would be calculated for a customer using 4,500 gallons; 75% (or 3,375) from Payson Water Company and 25% (or 1,125) from the Town of Payson.

	[A] Total Usage Assumption		[B] % of Gallons From Town of Payson	[C] Gallons In '000s From Town of Payson **Col A x Col B**	[D] Town of Payson Commodity Rate	[E] Rate per 1,000 gal **= Col [D]**	[F] **Surcharge** **Col C x Col E**
Block 1	4,000	x	25% =	1.000	$ 7.48	$ 7.48	$ 7.48
Block 2	500	x	25% =	0.125	$ 7.48	$ 7.48	$ 0.94
Total Usage Assumption	**4,500**			1.125			
						Total Monthly Surcharge	$ 8.42

Example 2 - High Usage Customer

This example illustrates how the surcharge would be calculated for a customer using 25,000 gallons; 75% (or 18,750) from Payson Water Company and 25% (or 6,250) from the Town of Payson.

	[A] Total Usage Assumption		[B] % of Gallons From Town of Payson	[C] Gallons In '000s From Town of Payson **Col A x Col B**	[D] Town of Payson Commodity Rate	[E] Rate per 1,000 gal **= Col [D]**	[F] **Surcharge** **Col C x Col E**
Block 1	4,000	x	25% =	1.000	$7.48	$ 7.48	$ 7.48
Block 2	21,000	x	25% =	5.250	$7.48	$ 7.48	$ 39.27
Total Usage Assumption	**25,000**			6.250			
						Total Monthly Surcharge	$ 46.75

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RESPONSIVE TESTIMONY OF
THOMAS J. BOURASSA

September 23, 2013

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524138.1/073283.0006

I. INTRODUCTION, PURPOSE AND SUMMARY

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Thomas J. Bourassa. My business address is 139 W. Wood Drive, Phoenix, Arizona 85029.

Q. ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS PROCEEDING?

A. On behalf of the Applicant, Payson Water Co., Inc. ("PWC" or the "Company").

Q. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY IN THIS PROCEEDING?

A. Yes, my pre-filed direct testimony was submitted in support of the Company's request to consolidate and expedite the financing and rate applications.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. I will testify in response to the Staff Report for Phase 1 filed on September 18, 2013. More specifically, I will provide comments on the Staff recommendations surrounding the debt surcharge mechanism related to the Company's request to borrow up to $275,000 from the Water Infrastructure Finance Authority of Arizona ("WIFA"). My testimony will include a response to Staff's recommendation to treat the proceeds of the WIFA loan surcharge as contributions-in-aid of construction ("CIAC"). I will also provide comments of the Staff recommended proposed Purchased Water Adjuster (PWA), with which the Company has a couple of concerns.

Q. PLEASE SUMMARIZE YOUR TESTIMONY.

A. I will testify as follows:

1) The Company is in agreement with the Staff WIFA debt surcharge calculation as illustrated on Staff Schedule CSB-1 and agrees that the proceeds will be kept in a segregated account to be used only to make the WIFA loan payments.

2) The Company does not agree with the Staff recommendation to treat the WIFA debt surcharge proceeds (all or in part) as CIAC. Such treatment is improper and will have the unintended consequence of depriving the Company of the ability to fully recover its investment and cost of capital in the future.

3) The Company conceptually agrees with the Staff recommended PWA but does not agree on the methodology for computing the surcharge contained in Attachment B and Attachment C. Staff's methodology will not allow the Company to fully recover its purchased water costs from the Town of Payson. I should also note, the illustrative computations presented by Staff significantly understate the expected Purchased Water Cost and as a result could lead to confusion on the amount of the expected surcharge. The actual commodity cost is expected to be $7.48 per thousand gallons, not the $2.75 cost of water from the Cragin pipeline. To alleviate this confusion, the Company provides its own illustrative examples based on the Staff methodology.

II. <u>WIFA DEBT SURCHARGE</u>

Q. PLEASE COMMENT ON STAFF'S WIFA DEBT SURCHARGE COMPUTATION.

A. I have reviewed the Staff WIFA debt surcharge computation methodology shown on Staff Schedule CSB-1. The Company agrees with the methodology and finds the computed example total surcharge of approximately $32,447 and the monthly surcharge computations (e.g. $7.44 per month for a 5/8x3/4 inch metered customer) as reasonable estimates based upon the currently available information. Obviously, the actual amounts may be different depending on the actual loan amount, tax impact, and customer counts at the time the Company submits its WIFA loan surcharge calculation.

Q. DOES THE COMPANY AGREE TO THE STAFF RECOMMENDATION THAT THE COMPANY SUBMIT THE WIFA LOAN SURCHARGE COMPUTATION WITHIN 15 DAYS OF THE LOAN CLOSING?

A. Yes.

Q. DOES THE COMPANY AGREE WITH STAFF THAT THE SURCHARGE PROCEEDS BE PLACED IN A SEGREGATED BANK ACCOUNT AND BE USED ONLY FOR THE PURPOSES OF MAKING PAYMENTS ON THE WIFA LOAN?

A. Yes.

Q. DOES THE COMPANY AGREE WITH STAFF THAT THE WIFA LOAN SURCHARGE PROCEEDS BE TREATED AS CIAC?

A. No, such treatment is improper. The revenues collected under that surcharge are no more CIAC than the revenues required to provide a return on and of any other plant investment funded with debt and/or equity. Under the utility ratemaking framework, utilities are provided a revenue requirement that includes revenues for depreciation recovery and capital cost recovery – the return on and of capital. While the loan surcharge is very specific, covering only a single plant investment, its purpose is essentially the same as other revenue increases the Commission finds are needed to provide the revenues to provide a return on and of plant investment. Granted, the loan surcharge revenue has an additional purpose of addressing the fact that the Company currently cannot cash flow the loan payments and to satisfy WIFA that the Company can repay the loan. But, that does change the underlying nature of the revenues provided under the surcharge.

Q. WHAT HAPPENS IF THE SURCHARGE REVENUES ARE TREATED AS CIAC?

A. Treatment of the WIFA loan surcharge revenues as CIAC will have the unintended consequence of depriving the Company of the ability to fully recover its investment and its cost of capital on that investment in the future.

Q. WHY?

A. Rate base will be reduced by the CIAC amounts, which will lead to lower earnings than are necessary to cover capital costs. It will also lead to lower depreciation recovery, which will reduce the cash flow needed to service the loan. The future WIFA loan payments on the $275,000 will stay the same, but the Company will have less cash flow (depreciation and operating income) to service the WIFA loan.

Q. CAN YOU ILLUSTRATE YOUR POINT THAT THE OPERATING INCOME AND DEPRECIATION IN A FUTURE RATE CASE WILL BE LOWER, RESULTING IN THE COMPANY'S INABILITY TO COVER ITS COST OF CAPITAL AND SERVICE ITS DEBT?

A. Yes. Let's assume the Company files its next rate case in five years. Also assume the annual $32,447 of WIFA loan surcharge will be in place for the five years. Also assume the depreciation rate is 2.0 percent and the WIFA interest rate is 4.99 percent. Considering only the $275,000 plant investment, the rate base with and without the WFA loan surcharge proceeds treated as CIAC at the end of the fifth year would be as follows:

	Surcharge Not Treated as CIAC	Surcharge Treated as CIAC
Plant-in-Service	$ 275,000	$ 275,000
A/D	(24,750)	(24,750)
Net Plant	$ 250,250	$ 250,250
Less: CIAC	$ -	$ 162,235
A.A. CIAC		(9,410)
Rate Base	$ 250,250	$ 78,605

As can be seen, the rate base is significantly less if the surcharge revenues are treated as CIAC. This will result in less operating income (earnings) being afforded to the Company is the next rate case. Operating income will be significantly less than interest expense (the capital cost).

To illustrate, the Year 5 required operating income, interest expense, and net income would be as follows:

	Surcharge Not Treated as CIAC	Surcharge Treated as CIAC
Cost of Debt	4.99%	4.99%
Required Operating Income (Rate Base x Cost of Debt)	$ 12,487	$ 3,922
Less: Interest Expense (year 5)	$ (11,932)	$ (11,932)
Net Income	$ 555	$ (8,010)

Again, this shows that the operating income determined from the rate base that includes CIAC is much lower and significantly less than the interest expense. In fact, the operating income of $3,922 covers only about a third of the interest expense. The operating income determined from the rate base that does not include CIAC covers all the interest expense. Remember, the interest expense is the cost of capital.

FENNEMORE CRAIG
PROFESSIONAL CORPORATION
PHOENIX

Q. WHAT ABOUT CASH FLOW?

A. The following is a year 5 cash flow computation:

	Surcharge Not Treated as CIAC	Surcharge Treated as CIAC
Operating Income	$ 12,487	$ 3,922
Depreciation, net of amortization	$ 5,500	$ 2,255
Cash Flow	$ 17,987	$ 6,178
Annual Debt Service (principal + interest)	$ 22,048	$ 22,048
Debt Service Coverage Ratio	0.82	0.28

This illustrates that the lower operating income and depreciation that will be afforded the Company when the WIFA loan surcharge is treated as CIAC provides significantly less cash flow. In the example above, the debt service coverage ratio is just 0.28, meaning there is less than a third the amount of cash generated in order to pay the annual debt service.

Q. IT APPEARS FROM YOUR ILLUSTRATION THAT EVEN IF THE LOAN SURCHARGE REVENUES ARE NOT TREATED AS CIAC THERE WILL BE INSUFFICIENT CASH FLOW. PLEASE EXPLAIN.

A. That is true. Since the depreciation rate is 2 percent (or 50 year investment recovery) and the loan amortization period is 20 years, the Company will be paying back the loan at a faster rate than it recovers through depreciation. The Company will have to make up the difference with other cash flows (if available) or possibly through the raising of additional equity or debt capital. This is the consequence of funding plant with loan repayment periods that are less than the depreciation recovery periods. These situations create financial risk.

Q. SHOULD ANY PART OF THE WIFA LOAN SURCHARGE BE TREATED AS CIAC?

A. No, for the reasons I discussed above.

III. PURCHASED WATER SURCHARGE

Q. PLEASE COMMENT ON STAFF'S RECOMMENDED PURCHASED WATER ADJUSTER.

A. I have reviewed the Staff purchased water surcharge tariff, methodology for computing the surcharge, and the illustrative surcharge computations as set forth in Attachment B and Attachment C of the Staff Report. The Company does not agree with the Staff methodology of computing the purchased water surcharge.

Q. WHY?

A. Because the Staff methodology does not allow full recovery of the purchased water costs the Company will incur from the Town of Payson. This is true because the Staff methodology subtracts the commodity costs (based on the tariffed commodity rates) from the Town of Payson commodity costs to compute the surcharge. This would be fine if the current commodity rates were designed to only recover the Town of Payson purchased water costs and no other costs. But, they are not. The commodity rates are designed to provide revenues to recover a portion of the Company's cost of service, which includes wages and salaries, purchased power, chemicals, water testing, contractual services, insurance, repairs and maintenance, depreciation, property and income taxes, etc. The tariffed commodity rates do not include any recovery of the Town of Payson purchased water cost and therefore these costs should be an addition to the tariffed commodity rates; not a net amount as contemplated by Staff.

Q. HOW SHOULD THE SURCHARGE BE COMPUTED?

A. Simply take the total cost of the water purchased from the Town of Payson and divide it by the total gallons sold (in 1,000 gallons). The result will be the per commodity rate (in 1,000 gallons). The resulting commodity rate is then multiplied by the customer's usage (in 1,000 gallons) to determine the surcharge. The surcharge will be a separate line item on the customer's bill.

Q. **CAN THE STAFF METHODOLOGY BE MODIFIED TO ACCOMPLISH THIS?**

A. Yes, simply remove any reduction to the Town of Payson purchase water costs related to the tariffed commodity rates. The methodology would then be as follows:

> If 100 percent of the water purchased from the Town of Payson, then the customer is charged the Town of Payson commodity rate which is currently estimated to be $7.48 per thousand gallons. The surcharge for a customer using 4,500 gallons would be $33.66 (4.5 x $7.48 x 100%).
>
> If less than 100 percent of the water the Company sells is purchased from the Town of Payson, then the commodity rate is reduced to the proportion of water purchased. The surcharge for a customer using 4,500 gallons when the total water purchased from the Town of Payson is 25 percent of the total gallons sold, the surcharge would be $8.42 (4.5 x $7.48 x 25%). The surcharge for a customer using 25,000 gallons when the total water purchased from the Town of Payson is 25 percent of the total gallons sold, the surcharge would be $46.75 (25 x $7.48 x 25%).

Q. **DOES THE COMPANY AGREE THAT THE PWA COST SHOULD BE A SEPARATE ITEM ON THE BILL?**

A. Yes, the amount of the adjuster will be a separate line item on the customer's bill.

Q. **DO YOU HAVE ANY ADDITIONAL COMMENTS?**

A. Yes. Putting aside the fact the Company disagrees with the Staff methodology, Staff's illustrative computations significantly understate the cost of the water creating confusion. Staff employs a cost of $2.75 per thousand gallons when the cost of purchased water is currently estimated to be $7.48 per thousand gallons.

Q. BUT DIDN'T STAFF GET THE NUMBER FROM YOUR TESTIMONY AND THE COMPANY'S DATA REQUEST RESPONSES?

A. Yes, but the $2.75 per thousand commodity rate is the estimated rate the Company will pay to the Town of Payson once the Cragin Pipeline project is completed, which is currently estimated to be sometime in 2016. The possibility of the currently contemplated Interconnection did not even exist when my direct testimony was filed. Moreover, as Mr. Williamson has previously testified, the Interconnection will deliver the same water that is currently being bought from the Town and hauled.[1] The $7.48 per thousand gallon commodity rate is the estimated current cost of water normally charged by the Town of Payson for water delivered by tanker truck or other means and in the absence of the Cragin Pipeline.

Q. HAVE YOU PREPARED EXHIBITS SHOWING ILLUSTRATIVE SURCHARGE COMPUTATIONS USING THE $7.48 COMMODITY RATE?

A. Yes. Attached as **Exhibit TJB-RT1** is an illustrative computation that compares to the illustrative computation contained in Attachment B of the Staff Report. This schedule shows a revised adjuster amount of $24.45 as compared to the Staff computed surcharge of $3.66.

Also attached as **Exhibit TJB-RT2** is an illustrative computation that compares to the illustrative computation contained in Attachment C of the Staff Report. Here, the revised surcharge amount for the usage assumption of $4,500 gallons is $6.11 as compared to the Staff computed surcharge of $0.79. This also shows that the revised surcharge amount for the usage assumption of $25,000 gallons is $29.12 as compared to the Staff computed surcharge of $(0.44).

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[1] Testimony of Jason Williamson (filed August 15, 2013) at 6:15-17.

Q. DOES THAT CONCLUDE YOUR RESPONSIVE TESTIMONY?

A. Yes.

EXHIBIT TJB-RT1

COMPANY REVISED STAFF COMPUTATION Exhibit TJB-RT-1

A customer uses 4,500 gallons of water.

The commodity cost being billed by Payson Water Company to this customer would be $8.71 calculated as follows:

Per 1,000 Gallons	1.93	4.0 x $1.93	=	$ 7.72
0 to 4,000	2.99	0.5 x $2.99	=	$ 1.50
				$ 9.22

The commodity cost billed from the Town of Payson would be:

Per 1,000 Gallons	7.48	4.5 x $7.48	=	$ 33.66

The surcharge fort his customer would be"

Purchased Water Cost		Water Cost per Company's Approved Tariff		Surcharge
$ 33.66	-	$ 9.22	=	$ 24.45

EXHIBIT TJB-RT2

Exhibit TJB-RT-2

COMPANY REVISED STAFF COMPUTATION

Surcharge Calculation Example - When Less Than 100% of All Water Purchased From Town of Payson

Examples assume that 25% of total water purchased from the Town of Payson

Example 1 - Median Usage Customer

This example illustrates how the surcharge would be calculated for a customer using 4,500 gallons; 75% (or 3,375) from Payson Water Company and 25% (or 1,125) from the Town of Payson.

	[A] Total Usage Assumption		[B] % of Gallons From Town of Payson	[C] Gallons In '000s From Town of Payson **Col A x Col B**	[D] Town of Payson Commodity Rate	[E] Payson Water Company Tariff Rate	[F] Difference in Rate per 1,000 gal **Col D - Col E**	[G] **Surcharge** **Col C x Col F**
Block 1	4,000	x	25% =	1.000	$7.48	$ 1.93	$ 5.55	$ 5.55
Block 2	500	x	25% =	0.125	$7.48	$ 2.99	$ 4.49	$ 0.56
Total Usage Assumption	**4,500**			1.125				
							Total Monthly Surcharge	**$ 6.11** *

*Excludes Taxes

Example 2 - High Usage Customer

This example illustrates how the surcharge would be calculated for a customer using 25,000 gallons; 75% (or 18,750) from Payson Water Company and 25% (or 6,250) from the Town of Payson.

	[A] Total Usage Assumption		[B] % of Gallons From Town of Payson	[C] Gallons In '000s From Town of Payson **Col A x Col B**	[D] Town of Payson Commodity Rate	[E] Payson Water Company Tariff Rate	[F] Difference in Rate per 1,000 gal **Col D - Col E**	[G] **Surcharge** **Col C x Col F**
Block 1	4,000	x	25% =	1.000	$7.48	$ 1.93	$ 5.55	$ 5.55
Block 2	21,000	x	25% =	5.250	$7.48	$ 2.99	$ 4.49	$ 23.57
Total Usage Assumption	**25,000**			6.250				
							Total Monthly Surcharge	$ 29.12 *

*Excludes Taxes